



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SB/SE:3

FROM: Mitchel S. Hyman
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Collection, Bankruptcy & Summonses

SUBJECT: Payment for Discharge of Lien or a Compromise to Release a
Lien on Property When the Underlying Income Tax Liability has
been Discharged in Bankruptcy

This responds to your request for Chief Counsel Advice on whether the Service in a Collection Due Process ("CDP") case may accept an offer in compromise in lieu of enforcing a lien on a personal residence when the underlying income tax liability has been discharged in bankruptcy. In accordance with I.R.C. § 6110(k)(3), this guidance should not be cited as precedent.

LEGEND

Year 1

Year 2

Date

Date 2

Date 3

Date 4

Date 5

Date 6

Date 7

Date 8

Date 9

Date 10

Date 11

ISSUE

In a CDP case, whether the Service should accept a payment for the discharge of a Federal tax lien or enter into a compromise to satisfy a lien on a personal residence, which is greater in value than the amount offered.

CONCLUSION

No, neither discharge or release, nor an offer in compromise, are available in this case. Because the taxpayers are no longer personally liable for taxes, we conclude that any compromise with the taxpayers would have no effect on the enforceability of the Service's lien on the property. Thus, compromise would not render the liability "fully satisfied or legally unenforceable" such that the tax lien could be released under section 6325(a) of the Code. Furthermore, payment of a lesser amount would not reflect the value of the Government's interest in the property in question such that a certificate of discharge could be issued under section 6325(b).

BACKGROUND

This CDP case involves a Federal tax lien on the taxpayers' personal residence, which arose from the assessment of taxes for Year 1 and Year 2. The taxpayers filed a Chapter 7 bankruptcy petition on Date, and an order of discharge was entered on Date 2. The Service identified the personal residence of the taxpayers as exempt property subject to the lien. On Date 3, the Service sent the taxpayers Letter 1058: Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing. On Date 4, the taxpayers timely requested a CDP hearing.

On Date 5, the taxpayers filed a Motion to Enforce Discharge in the bankruptcy court, and in response, on Date 6, the court ordered that the taxpayers' case be reopened. On Date 7, the bankruptcy court specifically held that the Year 1 and Year 2 income taxes were discharged, but that the Service could enforce its lien against any exempt property of the debtors.

A CDP hearing between the taxpayers and an appeals officer was held on Date 8 and Date 9. On Date 10, a Notice of Determination was sent to the taxpayers sustaining the proposed levy action. On Date 11, the taxpayers timely filed a petition for the judicial review of the determination.

You have recommended that this case should be resolved in one of two ways. First, you have suggested accepting an amount which is smaller than the value of the Service's lien on the property in return for the discharge of the lien because, for all practical purposes, the liability is unenforceable due to problems arising from the seizure of the taxpayers' personal residence. Second, you have suggested that the lien could be released by accepting a smaller amount than the value of the lien on the property through an offer in compromise under section 7122.

DISCUSSION

For the reasons discussed below, we recommend that the Service only settle this case for an amount equal to the value of the lien.

The doctrine of lien pass through was first announced in Long v. Bullard, 117 U.S. 617 (1886). It holds that a perfected lien may pass through the bankruptcy unscathed to the extent the liability it secures is not satisfied and the lien is not subordinated or set aside by the Bankruptcy Code. In practice, a Federal tax lien will usually survive discharge only when a Notice of Federal Tax Lien has been filed and only to the extent it is secured by property that was exempt or excluded from the bankruptcy estate or abandoned by the trustee. When a debtor receives a discharge but the lien nevertheless survives the bankruptcy, the debtor is no longer personally liable for the debt the lien secures. See Johnson v. Home State Bank, 501 U.S. 78, 82-83 (1991). The Service can, however, bring an in rem action to collect from the property by using its administrative collection powers.

Section 6325(a)(1) provides that a lien must be released by the Service when it determines that "the liability for the amount assessed . . . has been fully satisfied or has become legally unenforceable." "'Unenforceable' means unenforceable as a matter of law, and not merely uncollectible." IRM 5.12.2.2.2(1). When a liability has been discharged in bankruptcy but the lien continues to attach to the debtor's property, release of the lien is not required because the liability continues to be legally enforceable against the subject property. See In re Wrenn, 40 F.3d 1162, 1164 (11th Cir. 1994) (citing Dewsnup v. Timm, 502 U.S. 410, 417-418 (1992)); In re Isom, 901 F.2d 744, 745 (9th Cir. 1990).

Section 6325(b) sets forth the conditions under which the Service may issue a certificate of discharge with respect to a specific property subject to a lien. Discharge of a lien in exchange for partial payment of the liability is only authorized where the amount paid is at least equal to the value of the Government's interest in the property. See I.R.C. § 6325(b)(2)(A); Treas. Reg. § 301.6325-1(b)(2)(i). The section provides no discretion to accept some amount less than the value of the lien.

Section 7122 grants the Secretary authority to compromise cases. A compromise is an agreement with a particular taxpayer or taxpayers that settles a determined and

assessed tax liability for less than the total amount owed. The effect of a compromise is clearly set out in Treasury Regulations, which state:

Acceptance of an offer in compromise will conclusively settle the liability of the taxpayer specified in the offer. Compromise with one taxpayer does not extinguish the liability of, nor prevent the IRS from taking action to collect from, any person not named in the offer who is also liable for the tax to which the compromise relates.

Treas. Reg. § 301.7122-1(e)(5). Thus, the taxpayer is released from personal liability but the Service may continue to pursue collection from other persons liable for the tax. The regulations contemplate that compromise occurs between the Service and a particular taxpayer, and that the compromise does not act to eliminate or alter the underlying assessment itself.


In the case of a lien which has survived bankruptcy notwithstanding a discharge of the taxpayer/debtor's personal liability, the lien is enforceable only as an in rem claim and the taxpayer is no longer personally liable. As such, section 7122 is not applicable because that section authorizes only agreements to compromise "civil or criminal liability for taxes, interest, or penalties," not agreements for the release or discharge of liens. Treas. Reg. § 301.7122-1(a)(2). Compromise with the taxpayer as an individual would have no effect on the enforceability of the lien for purposes of the analysis under section 6325(a), because the taxpayer has already been relieved of the obligation the compromise would purport to cover. Following such a compromise, the Service would be left with the same ability to collect as it had prior to accepting the offer. Under section 6325(a), lien release would not then be authorized or required. Similarly, compromise with the taxpayer in this case would not authorize lien discharge under section 6325(b).

The Service may compromise when there is doubt as to liability, doubt as to collectibility, or where compromise would promote effective tax administration. Treas. Reg. § 301.7122-1(b). In this case, there has been no suggestion that the existence or amount of the tax liability is in doubt. The value of the property far exceeds the amount of the lien and no creditor has priority over the Service, so there is no doubt that the lien amount can be collected in full. ^{1/} The request for advice does not indicate facts that

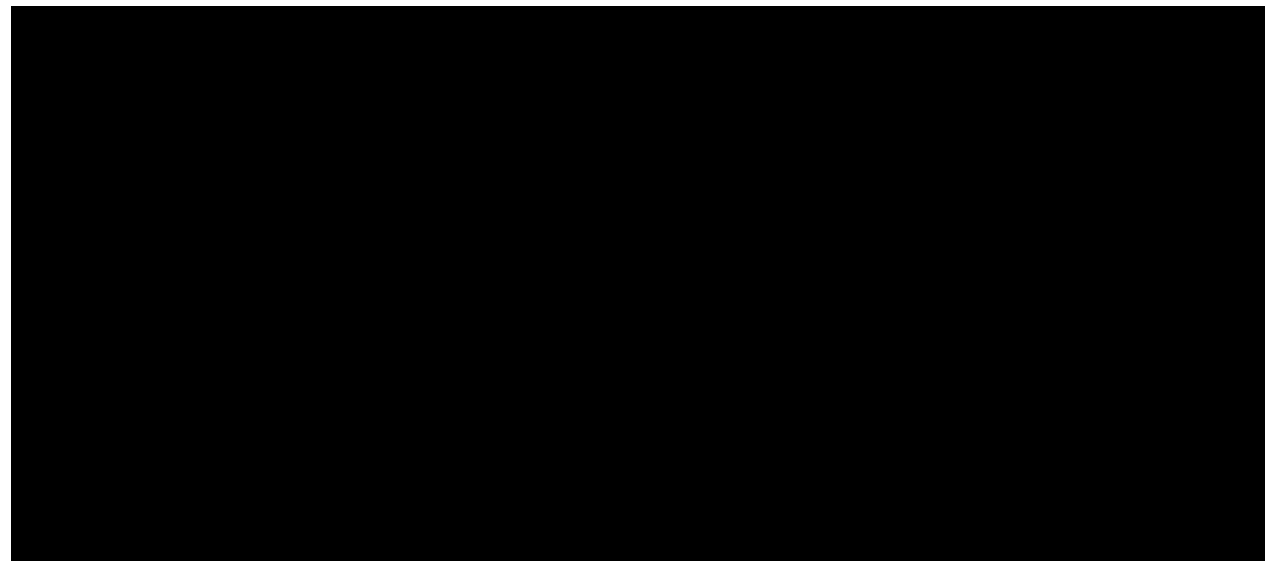
^{1/} We are unaware of a case in which a bankruptcy discharge has been granted, but the lien passed through, in which there could be doubt as to collectibility with respect to the in rem liability that can be asserted against the property. By definition, the value of the in rem claim is limited to the interest in the property to which the lien attached. As a non-recourse debt secured by property, any loss of value in the property diminishes the value of the Service's claim. Thus, at any point, the collection potential from the property is equal to the Service's claim and can therefore always be collected in full.

would authorize compromise to promote effective tax administration. Compromise on that basis is authorized only where collection in full would cause economic hardship or where compelling equity or public policy considerations identified by the taxpayer provide a sufficient basis for compromise. See Treas. Reg. § 301.7122-1(b)(3).


While seizure of the residence would force the taxpayers and their dependents to find new housing, the financial analysis does not support the conclusion that other housing could not be obtained or that doing so would cause economic hardship as defined in applicable Treasury Regulations. In fact, the financial analysis supports the conclusion that the taxpayers have the ability to pay in full and thereby could avoid the seizure of the property. The act of enforcing the lien on the property despite the bankruptcy discharge does not rise to an authorized reason for compromise under the regulations. See I.R.M. 5.8.11.2.2(2) ("Compromise . . . is not authorized based solely on a taxpayer's belief that a provision of the tax law is itself unfair.").



deference must be given to the Service's determination that there is sufficient equity in the taxpayers' residence to warrant a levy. Additionally, the Service may not levy on a taxpayer's principal residence without obtaining judicial approval from the district court under I.R.C. § 6334(e). If the taxpayers would like to challenge the propriety of having a lien foreclosed on their personal residence, they may raise this issue in the district court.



2/ Should the taxpayer default on a non-payment term of the compromise, the Service is authorized to revoke the certificate of release. I.R.C. § 6325(f)(2).



For the above-mentioned reasons, we conclude that neither compromise, release, nor discharge is appropriate under the facts of this case.

This advice has been coordinated with Branch 2 of Collection, Bankruptcy and Summonses. If you have any questions concerning this matter, please contact